David Mead - Committee presentaion

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Dave- a copy of my committee presentation is attached.

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Wood Product Industry Trends and Michigan Forests
Legislative Report given 5/12/05

Global Influences

The last decade has seen a significant number of corporate mergers and acquisitions creating large global forest products companies that are more responsive to market fluctuations. Paper and wood products companies are also downsizing and divesting themselves of 'non-core' businesses and assets to increase their competitive advantage and profits. Corporate decisions are made for global market and business positioning as opposed to regional or local considerations.

Investing in forests and operations overseas provides numerous business advantages over North America and the United States.

- Low risk investment for capital.
- Favorable new construction incentives.
- Proximity to world markets.
- Less government regulation.
- Lower labor costs.
- Lower forest harvesting costs.

- Reduced or no environmental protection costs (e.g. streamside management, Threatened and Endangered species).

Forests in tropical and sub-tropical areas have higher wood fiber productivity than Michigan's temperate forests. In addition, wood technology processes are being developed to better utilize the characteristics of the faster growing tropical species more so than for the slower growing Michigan species.

In tropical forests

- Fiber growth rates[1] up to six times Michigan's average rate.
- Shorter fiber production rotations (35 years).
- Engineering and manufacturing innovations that are compatible with fast growing fiber characteristics.
- Technological innovations that increase fiber productivity.
- Plantation wood fiber that can be certified under forest certification systems (notably Forest Stewardship Council).

Forest products companies are moving their manufacturing operations to be closer to the wood supply. Weyerhaeuser recently purchased forest plantations and began building a facility in Uruguay. Mead Westvaco

[1] More than six times Michigan's average growth rate. Intensively Managed Forest Plantations (IMFPs) achieve 300 cubic feet per acre per year (ft^3/ac/yr) where growth rates of forest stands in Michigan range from 25 (ft^3/ac/yr) in northern hardwoods to 75ft^3/ac/yr in single species red pine plantations. Jack pine and Aspen growth rates are 30ft^3/ac/yr and 48ft^3/ac/yr respectively.

purchased a Brazilian consumer and office products company to promote its international expansion. Stora Enso is building a pulp mill in Brazil.

Worldwide, forestry is adopting an agricultural production model for growing timber through tropical and subtropical Intensively Managed Forest Plantations (IMFPs). These forests are geared towards maximizing fiber outputs with minimal consideration of other social, economic and biological benefits. There has been unprecedented investment in IMFPs in the last 20 years. The fiber from these plantations will form a 'wall of wood' by 2020 that is expected to provide nearly half the world's industrial wood (today it is 1/3 of the supply).

National Influences

Forests in the United States are valued for a broad range of public values and benefits. These include water and air quality, biological diversity, recreation, aesthetics, spiritual values, habitat, and ecological/natural processes as well as wood fiber. Most private forest landowners hold forest land for non-timber reasons; recreation, aesthetics, residence.

Unlike the global trend toward wood fiber plantations, most U.S. forests are managed as 'natural forests'. Natural forests are forests where natural processes, aesthetics, habitat, species diversity, water, soil and stream outputs are desired and part of the management mix.

Forests in the United States have several competitive disadvantages related to global timber production:

- Higher cost of labor.
- Higher cost of owning timber land including taxes.
- Higher cost of environmental compliance.
- Environmental protection regulations have limited access to timber, for example along streams, soil and sedimentation restrictions and wildlife habitat protection.
- Higher transportation costs to new world markets, e.g. China.
- Higher cost of harvesting.
- Lower annual growth rates (relative to world forests).
- Public Forests are becoming valued more for non-timber services and products such as recreation.
- Forest landowners exclude industrial wood production to favor other values: recreation, second homes, biodiversity.

Since 2002, MeadWestvaco has reduced its U.S. land holdings from 3.2 million acres to 1.2 million acres, citing other low fiber output and alternative high investment opportunities. In addition, Mead Westvaco sold its Papers assets including the Escanaba mill and forestland holdings to focus on growth markets in Asia and Latin America. In 2004 International Paper sold 1.1 million acres of forest land in the northeast and plans to sell 1.5 million acres of their southern forest holdings.

State Influences

Michigan's 19.3 million acres of forestland is a significant asset to the state, communities, citizens and forest-based industry. Collectively, these forests are a massive base (growing stock) that can provide stable annual harvests of wood fiber.

Michigan, and the Great Lakes region, has several influences that are favorable for the wood industry:

- Positive growth-to-removals (harvest) ratio.
- Highly educated workforces.

- Favorable location relative to population centers and major North American markets.
- Likelihood of continued growth in wood product consumption in the U.S. and worldwide.

Disadvantages include:

- Reduction in wood fiber from Michigan's national forests.
- Parcelization of (dividing up) large forestland holdings.
- Low level of harvesting from private forests (non-industrial owners) relative to growing stock and annual growth rates.
- Slower annual growth rates compared to other parts of the world.

The most recent forest inventory estimates net annual forest growth in Michigan to be about 930 million cubic feet per year while removals represent approximately 1/3 that growth. There are a variety of factors that contribute to this statistic. Much of the growth is on private lands and timber harvesting is a low priority for most private landowners. National forests have expanded their protection of recreational and ecological values which are contributing factors to reduced harvests from federal holdings.

In addition, forest growth rates vary by stand age. Rates remain stable or increase until the forest stand reaches maturity when annual growth rates and forest health begin to decline. A young aspen stand will have a higher growth rate but less volume than a mature aspen stand that has a slower growth rate and significant wood fiber. A forest comprised of younger-aged stands will have greater growth rates and less wood available for harvest than older stands. Growth-to-removal ratios vary considerably by tree species.[2]

The favorable growth-to-removals ratio has provided opportunities for out-of-state forestry companies that have entered into the Michigan logging market. Mills in Michigan are facing significantly increased competition from out-of-state forest companies and much higher prices than in the recent past. More central and western UP timber is going to Wisconsin and Minnesota mills. A major international firm with several mills in Wisconsin is even considering barging hardwood pulpwood from the northern Lower Peninsula across Lake Michigan to supply their Wisconsin mills.

[2] Tree species that are harvested using a clearcut method tend to have a lower growth-to-removals ratio than species that are harvested using selection or single tree methods.

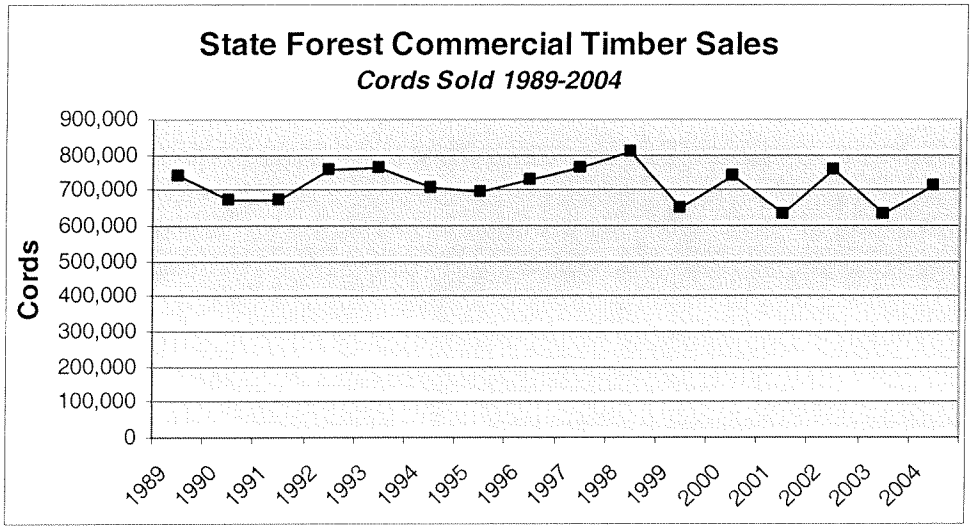
The potential to increase removals is constrained by the decrease in local logging firms available to remove timber. Barriers include high capital outlay, labor and liability costs, high harvesting costs, business uncertainty and risk, and more profitable paying business alternatives. Discussed loggers going to FL for hurricane assistance

State Forest System Influences

In 2004 the State of Michigan, with strong support from the forest products industry and their customers, reaffirmed and codified the intent of state forest system management (Part 525, P.A. 451, 1994) to provide a mix of ecological/biological, social and economic values and benefits. In other words Certification. This policy decision reflects the importance of timber and non-timber forest values and precludes optimization of any single output on the State Forest System as a whole. For example, managing single species red pine plantations on a large scale to optimize fiber production (requiring use of fertilizer, herbicides) is not an acceptable forest management regime under State Forest management guidelines or forest certification principles used in the United States.

State Forest Management

A goal for timber supplied from State Forests is to have a consistent level of fiber available over time. Historically, Michigan forests were logged too heavily and created a "boom and bust" situation. The even flow of fiber from State Forests helps stabilize the forest products industry in Michigan. Since 1989, timber sale production from the State Forest System has consistently remained in the range of 600,000 cords/year to 800,000 cords/year.



In the 1980s much of the aspen on State Forests reached maturity. Most of these stands were harvested but some were not in order to have an even age-class distribution for future timber supply and wildlife habitat. Red pine that

was planted by the CCC in the 1930s is maturing today. In order to avoid a boom and bust, the plan is to spread harvests out over at least two decades. This will provide a stable fiber supply and a variety of wildlife habitat conditions.

There are numerous variables that affect the ability to harvest timber from the forest including resource protection and sustainability, environmental compliance, legal constraints and accessibility. These variables and their influence are expected to increase as non-timber activities increase and private forests are converted to other high value uses. Landowners are becoming less tolerant of timber harvests near their property. This has led to visual and other buffers reducing harvestable state forest acres and access to state land being denied by adjacent landowners.

At any given time, the DNR typically has open timber sales contracts with 1.2-1.6 million cords of timber. That is, the DNR has sold timber for harvesting but that timber has not been cut and removed. The amount of sold standing timber is a reasonable barometer for wood fiber market demand. If supplies are not keeping pace with demand, it should translate into smaller backlogs to cut, in turn, reducing the amount of uncut standing timber on sold timber sales. There had not been a reduction in the amount of

uncut standing timber on DNR open timber sales until March, 2005 when a dip in standing sold timber was noted.

Recommendations

In the global sphere, the Great Lakes region and Michigan has significant disadvantages in timber production that may outweigh advantages in the short and long term. Movement away from plantations -- as we are doing on public forests -- and toward greater biodiversity and environmental protection will move our forests toward slower growth rates and higher costs while most of the rest of the world is moving toward plantations, faster growth rates, and lower costs. While this is not necessarily a threat to some firms as they derive lower cost wood inputs from outside the region or make new investments elsewhere, it may be debilitating to the forests and communities in which these firms are currently located.

Recommendations include:

1. Establish a national forest policy framework recognizing the need to balance social, economic and biological values. Reiterate the

importance and value of timber harvesting as a forest treatment tool for long term forest health.

2. Work with USDA Forest Service to revise forest regulations so that they are proactive rather than reactive.
    a. Support annual, ongoing funding for implementation of national forest plans.
    b. Convene a blue ribbon committee to recommend NEPA revisions.
    c. Develop forest planning processes that reflect current and future forest management in a global context. Current regulations have created management paralysis. The National Forest planning framework is outdated and ineffective.

3. Improve the quality, reliability and availability of forest sustainability related data[R2]. Support increased funding of
    a. Forest Inventory and Analysis (FIA) data.
    b. Timber Products Output (TPO) surveys.
    c. Forest management research.

4. Promote forest certification on non-industrial private forest lands and National Forests [R1]

    a. Increase funding for technical and financial assistance in the areas of planning, utilization and marketing for states and private landowners.

5. Reduce the costs of managing private forests[R3].

    a. Restructure Federal and state tax policy for income, estate, and property tax to support long term forest tenure and active forest management.

6. Provide funding to support increased investment and research in new technology – technology that is cutting edge and environmentally and economically competitive. This could be in the form of a tax incentive. In Mr. Call's presentation last week, he indicated that capital investment was a major factor in keeping a mill competitive and keeping a mill competitive was a key to attracting capital investments. Incentives may assist in this area.

7. Expand DLEG support to work with the Timber industry.

In previous presentations we have heard industry's request for both a stable supply and a competitive price.

This is a free market system, so my assumption is that we are not hearing a request for price setting. But it is a fact that prices are very high in this area. You have probably heard many of the reasons – many of them related to the world wide demand created by war, the tsunami in Dec. 04 and Florida's devastating hurricane season in 04. Michigan's industry is currently seeing competition from Wisconsin producers which are also affecting the local prices. We can not control the price but we can and are attempting to help with cash flow.

1. DNR has been working to make our appraisal system more flexible,
2. We have retained a minimum 5% cash bond requirement for timber sales instead of the industry standard of 10% to help loggers with cash flow and capital,
3. We offer timber sales of varying size and value to enable large and small companies to compete for sales. and
4. We have subdivided timber sales into smaller payment units allowing loggers to cut incrementally without tying up all of their capital.

Regarding the stable supply- I would submit that the supply off of State land has been very stable- as mentioned earlier we have been between 600-800,000 cords per year since 1989. Certification may or may not provide more fiber from state lands but there are significant resources on Federal lands and on private lands. I mentioned some recommendations earlier for dealing with both of these issues. However, in addition to those recommendations, DNR does work with private land-owners providing technical assistance and outreach. We have Forest Stewardship grants from Federal dollars, with a 50% match, which can be used by landowners to contract for timber management plans. This program has not been as successful as any of us would like to see for a couple of reasons- the lack of interest by private landowners and the ability for consultants writing these plans to generate more income in other areas such as timber sales. There is also 1 million dollars in Forest Development Funds which is going to Department of Agriculture for Conservation District Foresters for technical assistance and outreach.

Last but not least, we often hear about "limiting factors" on State land dramatically reducing the amount of fiber available. Limiting factors was really a poor choice of names to describe a list of items which affect our ability to access some of the State Forest lands. These things include – READ LIST OFF CHART. The item most discussed is generally "two wet". IN

2005 there are 5,500 acres in this category. Allowing timber sales in these environmentally sensitive areas, without proper management, would be a major setback in our certification efforts and in fact prevent us from being certified. Can some of this acreage be put on the market? Maybe. We are willing to work with industry to establish pilot areas with third party review of gentle logging techniques- if it is paid for by the industry, by a supplemental from the Forest Development Fund.